

## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We have made statements under the captions “Prospectus Summary”, “Risk Factors”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Business” and in other sections of this prospectus that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as “may”, “might”, “will”, “should”, “expects”, “plans”, “anticipates”, “believes”, “estimates”, “intends”, “future”, “potential” or “continue”, the negative of these terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties, and assumptions about us, may include, among other things, projections of our future financial performance, our anticipated growth strategies and anticipated trends in our business as well as projections relating to our capital expenditure requirements, our network expansion plans, locations of new data centers, network operations centers and points of presence, expected deployment dates for capacity on trans-oceanic cable, our plans for transitioning customer traffic from leased capacity to our network, research and development initiatives and increases in sales and marketing personnel. These statements are only predictions based on our current expectations and projections about future events. Because these forward-looking statements involve risks and uncertainties, there are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed under the caption entitled “Risk Factors”. You should specifically consider the numerous risks outlined under “Risk Factors”.

## USE OF PROCEEDS

We estimate that the net proceeds from our sale of the 173,913,000 shares of Class A common stock we are offering will be approximately \$2.3 billion, assuming an initial public offering price of \$13.50 per share and after deducting estimated underwriting discounts and offering expenses payable by us. If the underwriters' over-allotment option is exercised in full, we estimate that our net proceeds will be approximately \$2.6 billion.

Of the net proceeds of this offering, we intend to use approximately \$1.8 billion for capital expenditures in connection with the expansion of our network infrastructure and the balance will be used for general corporate purposes, including working capital. We may also use a portion of the net proceeds to acquire or invest in businesses or products or to obtain the right to use complementary technologies. We have no current commitments or agreements with respect to any acquisition or investment. Pending these uses, we intend to invest the net proceeds in short-term, investment-grade, interest-bearing securities.

## DIVIDEND POLICY

We have never declared or paid cash dividends on our capital stock. We currently expect to retain earnings, if any, to finance the growth and development of our business. Therefore, we do not anticipate declaring or paying cash dividends on our common stock in the foreseeable future. The decision to pay dividends will be made by our board of directors from time to time in light of conditions then existing including, among other things, our results of operations, financial condition and capital expenditure requirements. We must also obtain the consent of Verizon to declare extraordinary dividends or make other extraordinary distributions on our Class A common stock. You should refer to the section in "Related Party Transactions" entitled "Recapitalization Agreement" for more information on this limitation.

## CAPITALIZATION

The following table sets forth our capitalization as of March 31, 2000:

- on an actual basis giving effect to the recapitalization that will take effect before this offering; and
- on a pro forma as adjusted basis to give effect to a \$178 million capital contribution by GTE and the sale of the shares of Class A common stock offered by us in this offering at an assumed initial public offering price of \$13.50 per share, after deducting estimated underwriting discounts and offering expenses payable by us.

This table should be read in conjunction with “Selected Combined Financial Data”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our combined financial statements and accompanying notes included elsewhere in this prospectus.

	As of March 31, 2000	
	Actual	Pro Forma As Adjusted
	(in thousands except share data)	
Short-term obligations, including current maturities . . . . .	\$ 74,220	\$ 74,220
Long-term obligations . . . . .	57,563	57,563
Stockholders’ equity:		
Class A common stock, par value \$.01 per share, 0 shares authorized, issued and outstanding, actual; and 1,600,000,000 shares authorized and 173,913,000 shares issued and outstanding, pro forma as adjusted . . . . .	—	1,739
Class B common stock, par value \$.01 per share, 21,000,000 shares authorized, 18,256,000 shares issued and outstanding, actual and pro forma as adjusted . .	183	183
Class C common stock, par value \$.01 per share, 800,000,000 shares authorized, 0 shares issued and outstanding, actual and pro forma as adjusted . . . . .	—	—
Additional paid-in-capital . . . . .	3,460,604	5,886,674
Other comprehensive income . . . . .	1,721	1,721
Accumulated deficit . . . . .	(1,516,741)	(1,516,741)
Total stockholders’ equity . . . . .	1,945,767	4,373,576
Total capitalization . . . . .	<u>\$2,077,550</u>	<u>\$4,505,359</u>

## DILUTION

After this offering, the Class A common stock will represent 90.5% of our outstanding common stock and the Class B common stock will represent 9.5% of our outstanding common stock. The Class B common stock is convertible at any time into shares of our Class A common stock representing 10% of our total common stock outstanding after the conversion. In circumstances that we describe elsewhere in this prospectus, our Class B common stock can convert into 800 million shares of Class A common stock or Class C common stock. We have prepared the information below to show the effect of this offering on our pro forma net tangible book value per share under either conversion.

Our pro forma net tangible book value as of March 31, 2000 was approximately \$1.6 billion. Pro forma net tangible book value per share represents our total tangible assets, assuming a capital contribution of \$178 million by GTE, less our total liabilities. Assuming conversion of the Class B common stock into shares of Class A common stock representing 10% of our total common stock outstanding after the conversion, our pro forma net tangible book value per share as of March 31, 2000 was approximately \$82.75 per share. Assuming the conversion of the Class B common stock into 800 million shares of Class A common stock or Class C common stock, our pro forma net tangible book value per share as of March 31, 2000 was approximately \$2.00 per share. The accretion or dilution in pro forma net tangible book value per share shown in the table below represents the difference between the amount per share paid by purchasers of shares of our Class A common stock in this offering and the net tangible book value per share of our common stock immediately following this offering.

Without taking into account any changes in pro forma net tangible book value after March 31, 2000, other than to give effect to the sale of the shares of Class A common stock offered by us at an assumed initial public offering price of \$13.50 per share, after deducting estimated underwriting discounts and offering expenses payable by us, our pro forma as adjusted net tangible book value as of March 31, 2000 would have been approximately \$3.8 billion, or \$19.92 per share of common stock assuming a 10% conversion, and \$3.95 per share of common stock assuming a conversion into 800 million shares. Such amounts result in dilution of \$62.83 per share to GTE, our sole stockholder, on the 10% conversion basis and dilution of \$9.55 per share to new investors purchasing shares of Class A common stock on the 800 million share basis. If the initial public offering price is higher or lower, the dilution to new investors will be greater or less. The following table illustrates the accretion and dilution in pro forma net tangible book value per share to new investors:

	10% Conversion	800 Million Share Conversion
Initial public offering price per share . . . . .	\$13.50	\$13.50
Pro forma net tangible book value per share as of March 31, 2000 . . . . .	\$ 82.75	\$2.00
(Decrease)/Increase per share attributable to new investors . . . . .	<u>(62.83)</u>	<u>1.95</u>
Pro forma as adjusted net tangible book value per share after this offering . . . . .	<u>19.92</u>	<u>3.95</u>
(Accretion)/Dilution per share to new investors . . . . .	<u><u>\$ (6.42)</u></u>	<u><u>\$ 9.55</u></u>

The following table summarizes on a pro forma basis after giving effect to the recapitalization, the capital contribution discussed above, as of March 31, 2000, the number of shares of common stock purchased from us, the total consideration paid to us and the average price per share paid by GTE as our sole stockholder, both on a 10% conversion basis and an 800 million share conversion basis. It also includes amounts to be paid by new investors purchasing shares of Class A common stock in this offering at an assumed initial public offering price of \$13.50 per share, before deducting estimated underwriting discounts and offering expenses payable by us.

	<u>10% Conversion Shares</u>		<u>800 Million Share Conversion Shares</u>		<u>Total Consideration</u>		<u>Average Price Per Share in 10% Conversion</u>	<u>Average Price Per Share in 800 Million Share Conversion</u>
	<u>Number</u>	<u>Percent</u>	<u>Number</u>	<u>Percent</u>	<u>Amount</u>	<u>Percent</u>		
(in thousands, except per share data)								
GTE . . . . .	19,324	10%	800,000	82%	\$1,599,000	41%	\$82.75	\$ 2.00
New investors . . . . .	173,913	90	173,913	18	2,348,000	59	\$13.50	\$13.50
Total . . . . .	<u>193,237</u>	<u>100%</u>	<u>973,913</u>	<u>100%</u>	<u>\$3,947,000</u>	<u>100%</u>		

## SELECTED COMBINED FINANCIAL DATA

The selected combined financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the combined financial statements and accompanying notes included elsewhere in this prospectus. The selected combined balance sheet data as of December 31, 1998 and December 31, 1999 and the selected combined results of operations for each of the years in the three-year period ended December 31, 1999 have been derived from our combined financial statements, which have been audited by Arthur Andersen LLP, independent public accountants, and are included elsewhere in this prospectus. The selected combined balance sheet data as of March 31, 2000 and results of operations for each of the quarters ended March 31, 1999 and 2000 have been derived from our unaudited financial statements included in this prospectus. The results of operations of the predecessor to Genuity for the six months ended June 30, 1997, have also been derived from financial statements which have been audited by Arthur Andersen LLP and are included elsewhere in this prospectus.

Our selected combined balance sheet data as of December 31, 1995, 1996 and 1997 and March 31, 1999 and the selected combined statement of operations data for each of the years in the two year period ending December 31, 1996 were derived from unaudited financial statements that are not included in this prospectus. The selected combined balance sheet data of the predecessor to Genuity as of December 31, 1995 and 1996 and June 30, 1997 and the selected combined results of operations data of the predecessor for each of the years in the two year period ended December 31, 1996 were derived from unaudited financial statements that are not included in this prospectus. The unaudited financial statements include all adjustments, consisting of normal recurring accruals, which we consider necessary for a fair presentation of the results of operations for these periods.

Our selected combined financial data set forth below, as of December 31, 1995, 1996, 1997, 1998 and 1999 and for each of the five years in the period ended December 31, 1999 include the financial position and results of operations of those operations that will constitute Genuity as of the completion of this offering. The selected combined financial data as of December 31, 1995 and 1996 and the results of operations for each of the years in the two-year period ended December 31, 1996 do not include the financial data of BBN Corporation. GTE acquired BBN Corporation effective June 30, 1997. This acquisition was accounted for as a purchase business combination and, consequently, the results of operations of BBN Corporation, excluding the operations of BBN Technologies, which are being retained by GTE, are only included in our results of operations for periods after June 30, 1997. The results of operations of our predecessor represent the results of operations of BBN Corporation, excluding the operations of BBN Technologies. The operations of BBN Technologies are not included in the financial results of either the predecessor or Genuity.

We have prepared the accompanying table to reflect our historical combined financial information in a manner consistent with stand-alone operations by reflecting transactions of GTE and balances attributable to us in our financial statements for all periods presented. The historical financial information may not be indicative of our future performance and does not necessarily reflect what our financial position and results of operations would have been had we operated as a separate, stand-alone entity during the periods covered.

	Predecessor			Genuity						
	Year Ended December 31,		Six Months Ended June 30,	Year Ended December 31,					Three Months Ended March 31,	
	1995	1996	1997	1995	1996	1997	1998	1999	1999	2000
	(in thousands, except per share data)			(in thousands, except per share data)						
<b>Results of Operations Data:</b>										
Revenues										
Access	\$ 24,323	\$112,109	\$ 94,126	\$ —	\$ —	\$ 128,838	\$ 350,777	\$ 555,603	\$ 128,038	\$ 183,285
Hosting	1,045	7,769	9,601	—	—	9,690	33,469	48,811	10,028	21,692
Transport	—	—	—	33,961	38,463	41,920	46,876	64,483	13,535	23,625
Other	300	2,452	2,591	—	—	3,035	14,880	37,569	5,682	19,250
Total revenues	25,668	122,330	106,318	33,961	38,463	183,483	446,002	706,466	157,283	247,852
Operating expenses										
Cost of goods sold	17,778	85,287	92,670	14,812	15,606	166,040	492,794	767,498	160,540	283,928
Selling, general and administrative	28,341	68,602	38,801	552	4,378	142,962	312,916	396,522	93,123	108,336
Depreciation and amortization	6,786	13,160	10,536	6,062	6,731	49,444	104,444	187,628	41,092	53,786
Operating income (loss)	(27,237)	(44,719)	(35,689)	12,535	10,656	(174,963)	(464,152)	(645,182)	(137,472)	(198,198)
Net income (loss)	\$ (35,404)	\$ (41,600)	\$ (37,663)	\$ 8,485	\$ 7,309	\$ (174,928)	\$ (468,559)	\$ (647,046)	\$ (138,580)	\$ (209,826)
Basic and diluted income (loss) per common share										
	—	—	—	\$ 0.46	\$ 0.40	\$ (9.58)	\$ (25.67)	\$ (35.44)	\$ (7.59)	\$ (11.49)
Basic and diluted weighted-average common shares outstanding										
	—	—	—	18,256	18,256	18,256	18,256	18,256	18,256	18,256
Pro forma as adjusted basic and diluted net loss per common share										
	—	—	—	—	—	—	—	\$ (3.37)	—	\$ (1.09)
Pro forma as adjusted basic and diluted weighted average common shares outstanding										
	—	—	—	—	—	—	—	192,169	—	192,169
<b>Other Data:</b>										
Cash flow provided by (used in) operating activities										
	\$ (60,200)	\$ (32,717)	\$ 2,496	\$15,028	\$ 8,349	\$ (90,927)	\$ (512,928)	\$ (403,842)	\$ (133,479)	\$ (119,395)
Capital expenditures	13,190	42,945	23,255	616	3,360	299,491	587,831	744,356	105,157	163,093
	As of December 31,		As of June 30,	As of December 31,					As of March 31	
	1995	1996	1997	1995	1996	1997	1998	1999	1999	2000
	(in thousands)			(in thousands)						
<b>Balance Sheet Data:</b>										
Cash and cash equivalents										
	\$ 36,082	\$102,870	\$ 78,773	\$ 222	\$ 304	\$ 3,063	\$ 13,883	\$ 6,044	\$ 541	\$ 17,118
Working capital	96,332	98,950	62,041	14,712	698	370,765	43,060	(287,362)	114,361	(180,484)
Property, plant and equipment, net	25,671	56,865	72,179	26,292	33,951	367,688	908,980	1,520,934	986,205	1,629,391
Total assets	157,432	216,589	218,102	60,123	58,735	1,094,576	1,685,969	2,343,132	1,785,867	2,461,854
Total long-term liabilities										
	82,840	80,495	83,334	6,162	1,964	132,462	176,649	133,553	170,035	70,584
Total liabilities	105,132	110,478	140,876	23,156	25,818	609,208	351,242	675,026	311,510	516,087
Stockholders' equity	52,300	106,111	77,226	36,967	32,917	485,368	1,334,727	1,668,106	1,474,357	1,945,767

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*You should read the following discussion in conjunction with our combined financial statements and the accompanying notes and other financial information appearing elsewhere in this prospectus.*

### **Components of Revenues**

We derive our revenues from three operating segments: access, hosting and transport. Our other revenues include international and value-added e-business services.

*Access.* Our Internet access services include dial-up, dedicated and digital subscriber lines. Our access revenues, which are derived from service providers and enterprise customers, are the largest component of our total revenues. Internet access customers typically sign one or two-year contracts providing for monthly-recurring service fees that are either fixed or based on capacity utilization. We also include in our access segment those revenues relating to the development, operation and maintenance of a nationwide dial-up network for America Online. We derived approximately 42% of our total revenues from America Online in 1997, approximately 53% in 1998, 52% in 1999 and 46% in the first quarter of 2000. Although we expect our revenues from America Online to increase in absolute dollar amounts, we also expect these revenues to decline as a percentage of our total revenues as we expand and broaden our revenue base. In December 1999, we extended our strategic relationship with America Online to provide it with additional dial-up as well as broadband backbone Internet services. In December 1999, we agreed to operate the existing dial-up network for AOL Japan, Inc., and we will be responsible for a significant portion of the continued expansion of that network. Our expanded contractual relationship with America Online extends through 2006. You should refer to the section in "Business" entitled "Our Relationship With America Online".

We also include in access revenues those revenues derived from our provision of dedicated Internet access to AT&T for resale to customers of its Business Communications Services Division in the United States. We derived approximately 10% of our total revenues from AT&T in 1997. That percentage decreased to approximately 7% in 1998 and approximately 2% in 1999 because our strategic relationship with AT&T, under which BBN Corporation acted as the exclusive provider for these services, was terminated in September 1997.

*Hosting.* Our web hosting services provide reliable hosting and a high speed network infrastructure as well as flexible, fast and secure hosting platforms and an experienced technical support staff. Our web hosting services include managed hosting, collocation, content delivery and high availability services. Our hosting revenues are based primarily on monthly fees for server management, physical facilities and bandwidth utilization. Our web hosting services contracts typically range from one to two years.

*Transport.* We provide a broad range of transport services. These services are generally purchased by telecommunications carriers and Internet service providers requiring additional capacity and do not include Internet access services. Our transport revenues are typically based on available bandwidth. Our transport services contracts typically range from one to two years.

*Other.* Other revenues include the results of our international business, which consist primarily of Internet access, and domestic value-added e-business services, such as managed security services, virtual private networks for secure data transmission and the transport of voice communications that have been converted to IP, commonly referred to as voice-over-IP. We charge for international access and hosting revenues on a basis consistent with our domestic services. We charge for our security and virtual private network services on a fixed, monthly recurring fee basis and we charge for our voice-over-IP services based on usage. The terms of our value-added e-business service contracts typically range from one to two years.



We believe that our hosting and other revenues will increase substantially as a percentage of our total revenues. We also expect to continue to experience declining prices in our access and transport services in the foreseeable future.

### **Components of Operating Expenses**

*Cost of Goods Sold.* Cost of goods sold consists primarily of the costs of leasing telecommunications circuits and labor and expenses of operating our network infrastructure. We also include in cost of goods sold the salaries and benefits of our technical, operations and customer service personnel as well as facilities administration, including rent, maintenance and utilities to support our data centers.

We expect our network infrastructure requirements to grow in conjunction with the growth of our overall business and, accordingly, expect our cost of goods sold to increase significantly in the future. We believe our investments in network infrastructure will cause our total data transmission costs to increase substantially in the near term because of higher network operating and maintenance expenses associated with this expansion. Although we expect our total data transmission costs to increase significantly in absolute dollar amounts as we expand, we also expect them to decline as a percentage of revenues in the future as we add and utilize additional capacity and migrate customers from our leased facilities to our own network.

*Selling, General and Administrative.* Selling, general and administrative expenses consist primarily of salaries and benefits for our marketing, sales and support personnel, advertising, trade shows, professional fees and legal and accounting services and other miscellaneous expenses. We expect selling, general and administrative expenses in the future to increase in absolute dollar amounts as we hire additional personnel, expand our operations, invest in new support systems and incur additional costs related to the growth of our business. More specifically, we expect that advertising expenses will increase substantially in the near term as we launch our advertising and branding campaign and substantially increase our sales force. However, we expect selling, general and administrative expenses to decline as a percentage of revenues.

*Depreciation and Amortization.* Depreciation and amortization expenses consist primarily of depreciation of our network infrastructure, including data center equipment and related assets, and amortization of our goodwill and other intangible assets. We expect these expenses to increase in the future as we invest significant capital to expand our network infrastructure and data center capacity.

In 1999, we completed the initial build-out of our high speed fiber network infrastructure in the United States and have started adding additional layers of capacity to meet existing and anticipated market demand. Our network infrastructure has over 17,500 route miles of optical fiber connecting over 100 metropolitan areas in the United States. Through our recent investments in undersea fiber optic cable capacity, we have expanded the reach of our network into Europe and Asia.

### **Basis of Presentation**

Our selected combined financial data as of December 31, 1995, 1996, 1997, 1998 and 1999 and March 31, 1999 and 2000 and for each of the five years in the period ended December 31, 1999 and the three months ended March 31, 1999 and 2000 include the financial position and results of operations of those operations that will constitute Genuity as of the completion of this offering. Our combined financial data as of December 31, 1995 and December 31, 1996 and our results of operations for each of the two years in the period ended December 31, 1996 do not include the financial data of BBN Corporation. GTE acquired BBN Corporation effective June 30, 1997. This acquisition was accounted for as a purchase business combination and, consequently, the results of operations of BBN Corporation, excluding the operations of BBN Technologies, which are being retained by GTE, are only included in our results of operations for periods after June 30, 1997. The results of operations of our predecessor represent the results of operations of BBN Corporation, excluding the operations of BBN Technologies.

The following table sets forth our results of operations data derived from our audited financial statements and unaudited financial statements for the three months ended March 31, 1999 and 2000. For the purposes of the following discussion and analysis, the pro forma results of operations for the year ended December 31, 1997 combine the results of operations of our predecessor for the six months ended June 30, 1997 with the results of operations of Genuity for the year ended December 31, 1997, which includes the post-acquisition results of our predecessor effective July 1, 1997. This presentation was included to permit useful and complete year-to-year comparisons between the results of operations for the years ended December 31, 1997, 1998 and 1999. However, this pro forma restated information is not necessarily indicative of the operating results we would have achieved if we had acquired our predecessor on January 1, 1997. The first six months of 1997 did not include some operating expenses, amortization expense and allocations from GTE for centralized corporate services and infrastructure costs, which were included in the second six months of the year.

## Results of Operations

	Year Ended December 31,			Three Months Ended March 31,	
	Pro Forma 1997	1998	1999	1999	2000
	(in thousands)				
Revenues . . . . .	\$ 289,801	\$ 446,002	\$ 706,466	\$ 157,283	\$ 247,852
Operating expenses:					
Cost of goods sold . . . . .	258,710	492,794	767,498	160,540	283,928
Selling, general and administrative . . . . .	181,763	312,916	396,522	93,123	108,336
Depreciation and amortization . . . . .	59,980	104,444	187,628	41,092	53,786
Total operating expenses . . . . .	500,453	910,154	1,351,648	294,755	446,050
Operating loss . . . . .	(210,652)	(464,152)	(645,182)	(137,472)	(198,198)
Other income (expense)					
Interest expense, net . . . . .	(1,824)	(20)	(183)	(434)	(2,973)
Other, net . . . . .	318	(2,924)	(32)	(341)	(8,067)
Loss before income taxes . . . . .	(212,158)	(467,096)	(645,397)	(138,247)	(209,238)
Income taxes . . . . .	433	1,463	1,649	333	588
Net loss . . . . .	<u>\$(212,591)</u>	<u>\$(468,559)</u>	<u>\$ (647,046)</u>	<u>\$(138,580)</u>	<u>\$(209,826)</u>

The following table sets forth our results of operations data, including the pro forma data for 1997, expressed as a percentage of total revenues, for the periods indicated.

	Year Ended December 31,			Three Months Ended March 31,	
	Pro Forma 1997	1998	1999	1999	2000
Revenues . . . . .	100%	100%	100%	100%	100%
Operating expenses:					
Cost of goods sold . . . . .	89	110	109	102	115
Selling, general and administrative . . . . .	63	70	56	59	44
Depreciation and amortization . . . . .	21	23	27	26	22
Total operating expenses . . . . .	173	203	192	187	181
Operating loss . . . . .	(73)	(103)	(92)	(87)	(81)
Other income (expense)					
Interest expense, net . . . . .	(1)	—	—	—	(1)
Other, net . . . . .	—	(1)	—	—	(3)
Loss before income taxes . . . . .	(74)	(104)	(92)	(87)	(85)
Income taxes . . . . .	—	—	—	—	—
Net loss . . . . .	(74)%	(104)%	(92)%	(87)%	(85)%

### Three Months Ended March 31, 2000 Compared to Three Months Ended March 31, 1999

#### Revenues

	Three Months Ended March 31,			
	1999		2000	
	Amount	%	Amount	%
	(dollars in thousands)			
Access . . . . .	\$128,038	81%	\$183,285	74%
Hosting . . . . .	10,028	6	21,692	9
Transport . . . . .	13,535	9	23,625	9
Other . . . . .	5,682	4	19,250	8
Total . . . . .	\$157,283	100%	\$247,852	100%

Our revenues in the first quarter of 2000 increased \$91 million, or 58%, over the first quarter of 1999. The first quarter of 1999 included approximately \$11 million of revenues associated with our strategic relationship with AT&T. This contract has been terminated. If we exclude those revenues from the first quarter of 1999, total revenues increased 70%.

Access. Our access revenues in the first quarter of 2000 increased \$55 million, or 43%, over the first quarter of 1999. The increase in access revenues reflects an 80% increase in dial-up access modems deployed and a 24% increase in dedicated access customers. These increases were offset in part by lower prices, including the pricing structure associated with our new contract with America Online.

Hosting. Our hosting revenues in the first quarter of 2000 increased \$12 million, or 116%, over the first quarter of 1999, due to an increase in the number of our managed hosting customers.

Transport. Our transport revenues in the first quarter of 2000 increased \$10 million, or 75%, over the first quarter of 1999 due primarily to the increased sale of private line services.

Other. Other revenues in the first quarter of 2000 increased \$14 million, or 239%, over the first quarter of 1999 due to a \$5 million increase in sales of Internet access services in international markets and an \$8 million increase in value-added e-business services.

### Operating Expenses

Costs of Goods Sold. Our cost of goods sold in the first quarter of 2000 increased \$123 million, or 77%, over the first quarter of 1999. The increase was the result of the continued build out of our network infrastructure to provide access to a broader base of customers, support a growing customer base and provide increased scope to service customers of our Internet access services. Cost of goods sold, as a percentage of total revenues, was 115% in the first quarter of 2000 compared to 102% in the first quarter of 1999. The new pricing structure associated with the America Online contract contributed to the increase.

Selling, General and Administrative Expenses. Our selling, general and administrative expenses in the first quarter of 2000 increased \$15 million, or 16%, over the first quarter of 1999. This increase is attributable to costs associated with the expansion of our sales force and our marketing organization.

Depreciation and Amortization. Our depreciation and amortization in the first quarter of 2000 increased \$13 million, or 31%, over the first quarter of 1999. The increase is the result of capital expenditures associated with the continued build out of our network infrastructure.

### Net Loss

Our net loss increased to \$210 million in the first quarter of 2000 compared to \$139 million in the first quarter of 1999. We expect to continue to incur significant net losses over the next several years, given our planned operating and capital expenditures.

### 1999 Compared to 1998 and 1998 Compared to 1997

#### Revenues

	Year Ended December 31,					
	Pro Forma 1997		1998		1999	
	Amount	%	Amount	%	Amount	%
	(in thousands)					
Access .....	\$222,964	77%	\$350,777	79%	\$555,603	79%
Hosting .....	19,291	7	33,469	8	48,811	7
Transport .....	41,920	14	46,876	10	64,483	9
Other .....	5,626	2	14,880	3	37,569	5
Total .....	<u>\$289,801</u>	<u>100%</u>	<u>\$446,002</u>	<u>100%</u>	<u>\$706,466</u>	<u>100%</u>

Our revenues for 1999 increased \$260 million, or 58%, over 1998. Our revenues for 1998 increased \$156 million, or 54%, over 1997.

Access. Our access revenues in 1999 increased \$205 million, or 58%, over 1998. Our access revenues in 1998 increased \$128 million, or 57%, over 1997. These increases were due to an 87% increase in 1999 and a 76% increase in 1998 in the number of dial-up access modems deployed, primarily resulting from our expanded relationship with America Online, and to a lesser extent, an increase in the number of dedicated access customers. These increases were, in each year, offset in part by lower prices.

Hosting. Our hosting revenues in 1999 increased \$15 million, or 46%, over 1998, due to a 23% increase in the number of our managed hosting customers. Our hosting revenues in 1998 increased \$14 million, or 73%, over 1997 due in large part to our acquisition of a web hosting company in December 1997.

*Transport.* Our transport revenues in 1999 increased \$18 million, or 38%, over 1998, due to the sale of excess capacity on our network as we brought new network segments on line. Our transport revenues in 1998 increased \$5 million, or 12%, due to increased sale of private line services.

*Other.* Other revenues in 1999 increased \$23 million, or 152%, over 1998 due to an \$18 million increase in sales of Internet access services in international markets and a \$4 million increase in sales of voice-over-IP and managed security services. Other revenues in 1998 increased \$9 million, or 164%, over 1997, due to a \$5 million increase in international revenues and a \$3 million increase in sales of managed security services.

### ***Operating Expenses***

*Cost of Goods Sold.* Our cost of goods sold in 1999 increased \$275 million, or 56%, over 1998, and our cost of goods sold in 1998 increased \$234 million, or 90%, over 1997. Our cost of goods sold, in each case, increased as a result of the build-out of our network infrastructure to provide access to a broader base of customers, support a growing customer base and provide increased scope to service customers of our Internet access services. Our continued expansion of the dial-up network operated for America Online also contributed to the increase in cost of goods sold in 1999.

Our cost of goods sold, as a percentage of total revenues, was 89% in 1997, 110% in 1998 and 109% in 1999. To the extent we are able to increase our base of customers and correspondingly increase our revenues, we expect cost of goods sold to decrease as a percentage of our total revenues. Our telecommunications circuit costs represent a substantial percentage of cost of goods sold. These costs, which largely relate to long haul circuits, are expected to decrease as a percentage of our revenues as we migrate customers from our leased facilities to our own network.

*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses in 1999 increased \$84 million, or 27%, over 1998. This increase was due to a \$67 million increase in selling expenses that were directly attributable to an increase in the number of sales and sales-related employees, both domestically and internationally. The growth in our sales force resulted in higher training expenses and additional costs for expansion of field offices. Also contributing to this increase was a \$17 million increase in general and administrative expense resulting from the hiring of additional management staff and related operating expenses, increased facilities costs and increased information technology expenses.

Our selling, general and administrative expenses in 1998 increased \$131 million, or 72%, over 1997. Selling expenses increased \$45 million due to customer growth, higher new product development costs and investment in our sales and marketing infrastructure, including expansion of sales channels, advertising costs and other promotional activities related primarily to Internet-based services for enterprise and service providers. General and administrative expenses increased \$86 million due to increases in management staff and related operating expenses across the organization, as well as increased cost of Year 2000 renovation and system testing.

*Depreciation and Amortization.* Our depreciation and amortization expenses in 1999 increased \$83 million, or 80%, over 1998. This increase reflects our continuing investment in our network infrastructure in order to support our growth in customers and services. At December 31, 1999, over 17,500 miles of our fiber optic network were operational and, therefore, being depreciated.

Our depreciation and amortization increased \$44 million, or 74%, in 1998 over 1997. The increase reflects the continuing investment in our network infrastructure, which had over 5,900 miles of fiber deployed and operational and, therefore, being depreciated. In 1998 we also had a full year of amortization of goodwill related to two acquisitions in 1997, compared to a half year of amortization expense in 1997.

## Net Loss

Our net losses increased to \$647 million in 1999 compared to \$469 million in 1998 and \$213 million in 1997. Our net losses increased to \$210 million in the first quarter 2000 compared to the first quarter 1999. Given our planned operating and capital expenditures, we expect to continue to incur significant net losses over the next several years.

## Income Taxes

Our tax provision was computed on a stand-alone basis. Since July 1, 1997, our federal income tax returns have been filed on a consolidated basis with GTE. We generated taxable losses of \$115 million in 1997, \$527 million in 1998, \$638 million in 1999 and \$179 million in the first quarter of 2000, which were benefited by GTE in its consolidated income tax return. We received reimbursements for these tax benefits of \$40 million, \$186 million and \$224 million for the years ended December 31, 1997, 1998 and 1999 and \$62.5 million for the three-month period ended March 31, 2000. To reflect our income tax provision on a basis that will be comparable to future periods, these reimbursements have been accounted for as capital contributions. Our tax provision represents amounts owed for state taxes. Our ability to use net operating losses may be subject to annual limitations. We may also pay income taxes in the future due to operating income in some states and foreign countries. In the future, if we achieve operating profits and the net operating losses have been exhausted or have expired, we may experience significant tax expense.

## Quarterly Results of Operations

The following table sets forth our unaudited quarterly results of operations data for each of the nine quarters in the period ended March 31, 2000. This data has been derived from our unaudited combined financial statements. We believe that this information has been prepared on the same basis as our audited combined financial statements and that all necessary adjustments, consisting only of normal recurring adjustments, have been included to present fairly the selected quarterly information when read in conjunction with our audited combined financial statements and accompanying notes included elsewhere in the prospectus. The operating results for any particular quarter are not necessarily indicative of the operating results for any future period.

	Three Months Ended								
	Mar. 31, 1998	June 30, 1998	Sep. 30, 1998	Dec. 31, 1998	Mar. 31, 1999	June 30, 1999	Sep. 30, 1999	Dec. 31, 1999	Mar. 31, 2000
	(in thousands)								
Revenues . . . . .	\$ 96,863	\$ 109,731	\$ 115,018	\$ 124,390	\$ 157,283	\$ 165,545	\$ 181,548	\$ 202,090	\$ 247,852
Operating expenses:									
Cost of goods sold . . . . .	101,397	118,173	127,613	145,611	160,540	178,856	206,260	221,842	283,928
Selling, general and administrative . . . . .	78,009	77,493	75,539	81,875	93,123	94,178	97,970	111,251	108,336
Depreciation and amortization . . . . .	21,071	23,272	28,071	32,030	41,092	44,148	49,831	52,557	53,786
Total operating expenses . . . . .	200,477	218,938	231,223	259,516	294,755	317,182	354,061	385,650	446,050
Operating loss . . . . .	(103,614)	(109,207)	(116,205)	(135,126)	(137,472)	(151,637)	(172,513)	(183,560)	(198,198)
Other income (expense):									
Interest income (expense), net . . . . .	(340)	200	2,115	(1,995)	(434)	391	948	(1,088)	(2,973)
Other, net . . . . .	(152)	(377)	(219)	(2,176)	(341)	(1,714)	(336)	2,359	(8,067)
Loss before income taxes . . . . .	(104,106)	(109,384)	(114,309)	(139,297)	(138,247)	(152,960)	(171,901)	(182,289)	(209,238)
Income taxes . . . . .	326	343	358	436	333	369	463	484	588
Net loss . . . . .	<u>\$(104,432)</u>	<u>\$(109,727)</u>	<u>\$(114,667)</u>	<u>\$(139,733)</u>	<u>\$(138,580)</u>	<u>\$(153,329)</u>	<u>\$(172,364)</u>	<u>\$(182,773)</u>	<u>\$(209,826)</u>

## Liquidity and Capital Resources

We have used cash in our operating and investing activities during all periods. We have funded these cash requirements principally through permanent contributions to capital from GTE and borrowings from its affiliates. Capital contributions amounted to \$611 million in 1997, \$1.3 billion in 1998, \$974 million in 1999 and \$488 million in the first quarter of 2000. We expect to continue to fund all of our cash requirements prior to this offering through permanent contributions of capital from GTE.

Net cash used in operating activities was \$91 million in 1997, \$513 million in 1998 and \$404 million in 1999. Net cash used in operating activities was \$119 million in the first quarter of 2000. Net cash used in operating activities for these years and the three-month period was primarily the result of operating losses.

Net cash used in investing activities was \$774 million in 1997, \$505 million in 1998 and \$701 million in 1999. Net cash used in investing activities in each of these years was primarily the result of capital expenditures for construction of our network infrastructure, as well as leasehold improvements, furniture, fixtures, computers and other equipment. Our capital expenditures for the three-year period ended December 31, 1999 totaled over \$1.4 billion. Our net cash for investing activities in 1997 included the acquisitions of BBN Corporation, our predecessor, and a web hosting company, which together totaled \$518 million. Net cash used in investing activities was \$212 million for the first quarter of 2000 due primarily to the result of capital expenditures for the continued construction of our network infrastructure. Our capital expenditures in the first quarter of 2000 were \$211 million.

We currently intend to spend approximately \$1.8 billion to \$2.0 billion during the year ended December 31, 2000 on capital expenditures, of which approximately \$1.2 billion is expected to be spent on the continued expansion of our fiber optic network and approximately \$250 million is expected to be spent on the construction of additional data centers. As of March 31, 2000, we had entered into \$401 million in commitments for these projected expenditures.

Our capital expenditures program, as currently contemplated, will require between \$11 billion and \$13 billion over the five-year period ending December 31, 2004, the majority of which will be for the expansion of our network infrastructure. We expect capital expenditures to continue to increase significantly beyond this period, depending on the pace at which we build and expand our network infrastructure and increase our employee base to support our operations and invest in our selling and marketing organization. In the near term, we believe that the proceeds from this offering, along with the capital contribution from GTE prior to this offering that will offset intercompany debt as well as any outstanding external debt as of the closing of the offering, should be sufficient to meet our cash needs through the first quarter of 2001.

Our future cash requirements, however, will depend on a number of factors, including:

- the pace at which we expand our network infrastructure and the associated costs;
- the rate at which customers purchase our services and the pricing of those services;
- the level of marketing required to build our brand, to acquire and retain customers and to maintain a competitive position in the marketplace;
- the rate at which we invest in support systems and engineering; and
- investment opportunities in complementary businesses or technologies.

We will be required to raise additional capital to fund our business plan as currently contemplated. We cannot predict the timing and exact amount of capital that we will be required to raise. We expect to raise this capital principally through public offerings or private placements of debt or equity securities, depending on market conditions. The issuance of additional equity would be dilutive to the holders of our Class A common stock. We are required to obtain the consent of Verizon or other future holders of our Class B common stock

prior to issuing shares of our capital stock in excess of specified limits and our agreement with Verizon limits our ability to incur debt in excess of agreed upon amounts. You should refer to "Description of Capital Stock" and the section in "Related Party Transactions" entitled "Recapitalization Agreement" for more information regarding limitations imposed on us by our charter and contractual relationship with Verizon. If we are unable to obtain required additional capital through the issuance of these securities or are required to obtain it on terms less satisfactory than we desire, we may be required to delay the expansion of our business.

As of March 31, 2000, our indebtedness included \$49 million of 6% convertible subordinated debentures. These debentures are due in 2012 and may be converted at any time by the bondholders into cash at an exchange ratio of \$966.67 for each \$1,000 in principal amount of debentures. The debentures are unsecured obligations of Genuity and are subordinated in right of payment to our senior indebtedness, if any. We are required to contribute to a sinking fund annual payments equal to 5% of the aggregate principal amount issued. As of December 31, 1999, we had purchased and retired debentures with an aggregate principal of \$37.3 million, which satisfies the annual sinking fund requirements through 2006.

As of March 31, 2000, our indebtedness also included \$83 million in capital leases. The capital leases bear interest at 5.07% to 9.50% and have terms of 5 years from the date of purchase, with principal and interest payable quarterly in advance.

In addition, in the future we may wish to selectively pursue possible strategic investments in businesses, technologies or products complementary to ours in order to expand our geographic presence and achieve operating efficiencies. We may not have sufficient liquidity, or we may be unable to obtain additional debt or equity financing on favorable terms or at all, to finance these investments.

#### **Year 2000**

We do not believe that the Year 2000 rollover has had, or will have, any material adverse impact on our operating results or liquidity. We have not experienced any material contingencies with customers or major suppliers nor have we experienced any significant Year 2000 events. The estimated total cost of our Year 2000 compliance efforts is expected to total approximately \$60 million, of which \$54 million has been expended through March 31, 2000.

#### **Inflation**

We do not believe that inflation has had a material adverse impact on our business or operating results during the periods presented.

#### **Recently Issued Accounting Pronouncements**

The Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 101, Revenue Recognition in Financial Statements, on December 3, 1999. We are required to adopt this new accounting guidance, as amended by SAB No. 101A, no later than the second quarter of 2000. We implemented this accounting guidance in the first quarter of 2000.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. This new standard is not anticipated to have an impact on our combined financial statements based on our current structure and operations.



### **Quantitative and Qualitative Disclosure About Market Risk**

While our long-term debt bears fixed interest rates, the fair value of our fixed rate long-term debt is sensitive to changes in interest rates. There is a risk that market rates will increase and the required payments will exceed those based on the current market rates. The estimated fair value of long-term debt based on a debt pricing model was lower than its recorded value by approximately \$1.2 million as of December 31, 1998, by approximately \$6.6 million as of December 31, 1999 and by approximately \$6.8 million as of March 31, 2000. Under our current risk management policies, we do not use interest rate derivative instruments to manage our exposure to interest rate changes.

## BUSINESS

### Overview

We are a leading e-business network provider of high quality, managed Internet infrastructure services to enterprises and service providers. We offer a comprehensive suite of managed Internet infrastructure services, including:

- Internet access through dial-up, dedicated and digital subscriber lines;
- web hosting and content delivery; and
- value-added e-business services, such as virtual private networks for secure data transmissions and security services.

We operate a state-of-the-art global network that consists of:

- recently deployed broadband fiber optic cable in the United States;
- points of presence, which are locations where we provide Internet access to end users;
- secure data centers with redundant fiber connections to our network and backup power sources; and
- undersea and international fiber optic cable capacity.

Our large base of on-network users and content, combined with our extensive network, positions us as one of the leading Internet backbone providers in the world, a status commonly referred to as a Tier 1 Internet backbone provider. Tier 1 Internet backbone providers have the network scale and on-network traffic to offer their customers connectivity to virtually all addresses on the Internet either directly through their Internet backbone or through cost-free, high speed private connections to other Tier 1 Internet backbones. We believe that service providers are increasingly connecting to networks with substantial on-network content to improve the quality of their customers' experience, which in turn drives demand by enterprises seeking to connect to networks with large numbers of users. We believe that by taking advantage of this demand cycle, which we call the "network effect", we will continue to drive significant demand for our services from both enterprises and service providers and differentiate ourselves from non-Tier 1 Internet backbone providers.

### Industry Background

#### *The Growing Importance of the Internet*

The Internet has experienced tremendous growth in the past decade and has emerged as an important global medium for communications and commerce. The growth in data that is transmitted over the Internet is driven by a number of factors, including the rapidly increasing number of network-enabled and Internet-based applications, the growing number of personal computers linked to the Internet, advances in network-enabled devices, servers and routers and the increasing availability of broadband connections.

The explosive growth of the Internet and the increasing demand for data services are expected to continue. According to International Data Corporation, the number of Internet users worldwide will increase from 142 million at the end of 1998 to approximately 502 million by the end of 2003. In addition, according to International Data Corporation, the number of web pages is expected to grow from 1.7 billion in 1999 to approximately 13.1 billion in 2003. This growth is expected to lead to a substantial increase in the demand for bandwidth and other Internet infrastructure services.

The proliferation of the Internet within the business environment, in particular, has been substantial. Once primarily used for e-mail and retrieving information, the Internet is now being used as a communications platform for an increasing number of mission-critical Internet-based applications, such as those relating to

e-commerce, internal networks or intranets, telephone and facsimile capabilities, supply chain management, customer service and project coordination via extranets. The Gartner Group estimates that worldwide business-to-business e-commerce sales will grow from \$145 billion in 1999 to approximately \$7.3 trillion in 2004.

To improve the effectiveness and scalability of their critical Internet-based applications, both enterprises and service providers are requiring increasing levels of network performance, including capacity, reliability, security and manageability, across the Internet.

### ***The Growing Demand for Outsourced Internet Infrastructure Solutions***

As the Internet and data traffic have grown, the cost and complexity for enterprises and service providers to manage their own network infrastructure demands in-house has increased. Traditionally, enterprises were required to make substantial investments in developing the Internet expertise and infrastructure necessary to ensure the quality, reliability, security and availability of their Internet operations. The implementation and maintenance of Internet infrastructure solutions also require significant technical expertise and capital expenditures in a number of other areas, such as e-commerce systems, security and privacy technologies, advanced user interface and multimedia production. Moreover, the information technology departments within enterprises are constantly challenged by the need to implement their Internet business strategy, adopt new and rapidly changing technologies, transition to new broadband content applications and continuously update dynamically changing content. As a result, enterprises are seeking Internet infrastructure service providers that can minimize their exposure to the capital, human and technological risks associated with in-house solutions. To increase their competitive edge, enterprises are now outsourcing their critical Internet operations to increase performance and scalability, speed time-to-market and reduce costs.

Similarly, service providers are challenged by the rapid growth and increasing complexity of the Internet infrastructure, the dramatic increase in data traffic and the growing need to meet the demands of broadband applications. Service providers are increasingly required to devote substantial capital and human resources to expanding the capacity and the technological capabilities of their networks. As the demands of their customer base grow, these service providers find it more difficult to quickly, cost-effectively and efficiently deliver service through internal infrastructure expansion. As a result, service providers are increasingly focusing their resources on sales and marketing and outsourcing their Internet infrastructure requirements to organizations focused on developing and enhancing a high capacity Internet infrastructure that can be quickly expanded to meet their requirements.

### ***The Development of the Internet Infrastructure Services Market***

The growing demand from enterprises and service providers for outsourced Internet infrastructure services has led to the development of an Internet infrastructure service market comprised of companies focused on solving these outsourcing requirements. Many of these companies have endeavored to build or otherwise acquire network facilities in order to provide Internet access, while others have addressed more specific solutions, such as web hosting or security services. According to Forrester Research, the Internet access and web hosting markets in the United States are expected to grow from an aggregate of \$4 billion in 1998 to \$57 billion by 2003, representing a compound annual growth rate of approximately 70%.

Enterprises and service providers are increasingly demanding Internet infrastructure service providers that can deliver a high quality Internet experience for their users. The ability to deliver this high quality experience has become more difficult, largely as a result of an increasing number of Internet users and richer content, including graphics, photographs and streaming video and audio. In addition, as the number of networks connected to the Internet has grown, the delay and loss of data that is transmitted over the Internet has increased. This is particularly true at the major public peering points where multiple Internet service providers exchange data over shared facilities. To increase performance, a number of Internet backbone providers have established high-speed private connections with other networks to exchange traffic over dedicated fiber circuits.

These connections are referred to as private peering connections. The quality of an experience on the Internet is therefore highly dependent on the quality, capacity and reliability of the physical facilities over which Internet services are provisioned and the Internet backbone through which Internet access is provided and content is delivered.

The critical elements of delivering a high quality user experience are a large base of on-network users, content, and high speed, well-managed private peering relationships with other Tier 1 Internet backbones. Internet backbone providers that have these competitive strengths are able to route traffic to virtually all Internet addresses and avoid the need to route traffic across multiple networks and congested public peering points. Consequently, their users encounter fewer delays due to transmission bottlenecks across public peering points, and enterprise and service providers using these Internet infrastructure service providers are better able to manage the quality of experience of their end users.

Accordingly, enterprises and service providers increasingly look to the limited number of providers that offer a comprehensive suite of managed Internet infrastructure services, a large base of on-network users and content, and reliable and scalable network facilities. We believe that we are among only a few companies in the world that offer the full complement of these attributes as part of their e-business network solution.

## Our Solution

Our e-business network solution enables our customers to outsource their Internet infrastructure needs to a single provider and to scale their Internet operations in a cost-effective and reliable manner. The key elements of our solution include:

*Comprehensive Suite of Managed Internet Infrastructure Services.* We offer a broad range of managed Internet infrastructure services, including: Internet access; web hosting and content delivery; and value-added e-business services, such as virtual private networks for secure data transmission, security services and voice-over-IP. Our services are designed to enable customers to purchase the level of service, features, access speed and functionality that meet their existing requirements, while at the same time allowing them to easily upgrade services over time. We believe there is significant opportunity to offer integrated services to enterprise customers as their requirements evolve from Internet connectivity to more critical Internet applications. As part of our solution, we install, configure, maintain and monitor industry-leading hardware and software, offer technical consulting and support, provide high-volume backup and recovery systems and monitor our Internet backbone operations 24 hours a day, seven days a week. Additionally, we provide flexible service pricing that allows our customers to be billed according to their bandwidth and capacity utilization.

*Large Base of On-Network Users and Content.* Because we provide Internet access services to many of the leading Internet service providers, including America Online, Earthlink, NetZero and Web TV, web hosting services for popular web sites as Yahoo! and ZDNet, and high speed connections to enterprises that host their own web sites, such as Microsoft, we carry a significant amount of traffic over our Tier 1 Internet backbone. We believe enterprises and service providers choose to connect to our Internet backbone because they can directly route traffic to, or receive content from, a significant number of other customers on our network. This capability results in higher transmission speeds, lower instances of data loss and greater quality of service, thereby improving the overall quality of experience for Internet users. We believe that service providers are increasingly connecting to networks with substantial on-network content to improve the quality of their customers' experience, which in turn drives demand by enterprises seeking to connect to networks with large numbers of users. We believe that by taking advantage of this demand cycle, which we call the "network effect", we will continue to drive significant demand for our services from both enterprises and service providers and differentiate ourselves from non-Tier 1 Internet infrastructure service providers.

*State-of-the-Art Network.* We operate a state-of-the-art, high capacity global fiber optic network that is highly reliable and scalable. Over 85% of our fiber has been deployed within the past two years, and a majority

of our optical electronic equipment has been installed within the past year. Our highly redundant fiber optic network architecture is designed to minimize service interruptions in our network operations. We have significant additional capacity on our fiber network, which already carries a substantial portion of our traffic. This capacity allows us to scale quickly at favorable incremental capital costs as we meet increased customer demands and continue our transition from leased capacity. We also operate eight data centers in the United States, one data center in the United Kingdom and one in Japan, through which we provide managed and collocated web hosting services for enterprises with critical Internet operations. Through our technologically advanced data centers, we offer customers a secure environment to house critical Internet operations and to obtain high bandwidth connectivity to the Internet.

*High Performance, Tier 1 Internet Connectivity.* We provide high performance connectivity to the Internet through our Tier 1 Internet backbone and extensive high speed private connections to other major Internet backbone providers and, to a lesser extent, public peering points. Our extensive private peering relationships permit us to have direct, cost-free exchange of traffic with a significant number of telecommunications carriers and Internet infrastructure service providers, thus avoiding the congestion of public peering points when directing traffic to users connected to those Internet backbones. As a result, we are able to offer our customers direct access to our on-network users and content. In addition, over 80% of the traffic we deliver to the rest of the Internet is delivered through private peering connections.

*Significant Internet Protocol Engineering and Architectural Expertise.* Drawing upon the breadth and depth of our IP and networking experience and expertise, including over 750 engineers and over 1,100 technicians, we are able to quickly and cost-effectively identify the Internet infrastructure requirements of our customers and design and implement appropriate solutions. For service providers, this entails testing, certifying, deploying and scaling, within our network, the latest fiber optic and IP routing, switching and web hosting technology to provide cost-effective and highly reliable managed Internet infrastructure services. For our enterprise customers, we provide high quality IP solutions comprised of one or more of our services. For example, we combine our Internet access, web hosting, virtual private networks and managed security services to enable secure intranets and extranets for enterprises.

## **Our Strategy**

Our objective is to be the leading e-business network provider by architecting, building and operating the infrastructure for the Internet economy. The principal elements of our strategy for pursuing this objective include:

*Leveraging the Network Effect.* We intend to continue to target enterprises and service providers with significant Internet infrastructure demands. The addition of an increasing number of service providers enables us to cost-effectively scale our network and attract enterprises that seek to connect to networks with a large number of users. The additional users that these service providers bring to our network attract enterprises that want to market their products and services directly to a larger base of users. We believe that attracting these customers will enhance our position as a leading provider of managed Internet infrastructure services as a result of the consolidation of a growing number of users and large volumes of content on our Tier 1 Internet backbone. We also believe that over time the scale associated with an increasing customer base will also allow us to pursue premium pricing with enterprise customers and minimize operating expenses sometimes associated with private peering connections to other Internet backbones.

*Expanding Our Capacity and State-of-the-Art Network.* We intend to continue to expand our capacity and state-of-the-art network in advance of the capacity demands of our customers. We plan to do this by accomplishing the following by the end of 2001:

- extending our coverage by deploying up to an additional 4,500 route miles of fiber optic cable serving approximately 120 metropolitan service areas and 11 additional international markets;
- expanding our network capacity in the United States to the equivalent of 10 layers of 10 gigabit capacity each;

- increasing our number of dedicated points of presence to nearly 300 and deploying local fiber rings within selected metropolitan service areas to increase our reach to end users;
- adding seven additional data centers in key locations worldwide to address the growing demands for our web hosting and content delivery services;
- expanding our network collocation facilities to enable our service provider customers to reach new markets quickly and cost-effectively; and
- deploying state-of-the-art optical electronic equipment to maximize the capacity of our fiber network.

*Continuing to Build and Own Our Network Facilities.* As we expand, both domestically and internationally, we intend to build and own the majority of our network facilities rather than leasing them from other facilities-based providers. We believe that owning our network facilities:

- provides greater control over the performance, reliability and breadth of our managed Internet infrastructure services;
- enables us to increase our capacity more quickly to meet increasing bandwidth demands;
- generates higher gross margins than would be generated through leasing circuits from other facilities-based providers; and
- improves service delivery to customers by reducing reliance on third-party providers.

*Expanding Our Distribution Capabilities.* We intend to develop and expand our direct sales force and our strategic alliances with other Internet-focused companies in order to expand our distribution capabilities. Currently, we have over 350 persons in our direct sales force, and we intend to substantially increase this sales force by the end of 2001. During the same period, we plan to substantially increase our Electronic Business Consultant organization, which is a group of highly skilled sales consultants that aid our existing and potential customers in designing e-business solutions based on our managed Internet infrastructure services. In addition, through our eP@rtner Program, we have formed alliances with leading web integrators, e-business consultants, interactive agencies and other technology providers. We have formed similar alliances with international Internet service providers through our Net.Alliance program. This program enables these Internet service providers to offer our portfolio of IP-based services to their customers and is designed to allow us to provide our services to private and commercial customers in key European, Pacific Rim and Latin American markets. Our current partners in these programs include, among others, Agency.com, Cambridge Technology Partners, Cisco Systems, Ernst & Young, Hewlett-Packard, IBM, Lante, Microsoft, Nortel Networks and Sapient in the United States, Energis in the United Kingdom and I.NET and Tiscali in Italy. These alliances serve as a valuable, cost-effective channel for marketing our services. We also plan to expand our existing reseller relationships to significantly enhance our distribution capabilities.

*Pursuing Strategic Transactions and Alliances.* We intend to pursue selective acquisitions that will allow us to quickly and cost-effectively extend our geographic presence and customer base, particularly in international markets. Additionally, we intend to make strategic investments in or enter into joint ventures or alliances with complementary businesses to broaden our market presence or expand our strengths in key services. We believe that successfully pursuing these strategic transactions or alliances will enable us to expand our geographic and service reach and to broaden our Internet infrastructure services for our customers.

*Using Our Extensive Internet Protocol and Networking Expertise to Develop New Services.* We intend to use our long history of IP and networking expertise to strengthen our reputation as a leader in the development and deployment of innovative Internet infrastructure services. We were one of the first to offer commercially managed web hosting services and managed security services. We plan to continue to develop and introduce innovative services that address the evolving requirements of our enterprise and service provider customers. We are pursuing initiatives such as IP-based voice virtual private networks, enhanced multi-media streaming and

content distribution services and wireless and satellite access services. In addition, we plan to partner with or make investments in innovative Internet start-ups and other organizations to enhance both our access to and incorporation of leading technologies.

*Establishing Genuity as a Leading Brand for e-Business Network Services.* We intend to establish Genuity as a leading brand for e-business network services worldwide. We plan to increase brand awareness by pursuing an aggressive marketing strategy involving television, radio and print advertising as well as extensive public relations efforts. We will pursue additional marketing campaigns specifically targeted at enterprises and service providers. We also intend to build brand recognition by continuing to work closely with our eP@rtners and Net.Alliance partners to increase our exposure to a broader base of customers.

## **Our Services**

We provide a comprehensive suite of managed Internet infrastructure services targeted to two primary customer groups, enterprises and service providers. Our services fall into the following four categories:

- Internet access;
- web hosting;
- value-added e-business services; and
- transport services.

Our enterprise customers rely on our comprehensive suite of managed Internet infrastructure services to create and implement their e-business strategies. Our service provider customers rely primarily on our Internet access and web hosting services, which enable them to focus on the retail aspects of their business while we provide and manage the underlying scalable infrastructure necessary to deliver services to their customers. We believe our focus on developing and tailoring services to meet the needs of our target customers, as well as the scale and diversity of our services, differentiates us from our competitors.

*Internet Access.* We offer a variety of Internet access services to our enterprise and service provider customers, including dial-up, dedicated and digital subscriber lines. We also provide a range of customer premise equipment that is necessary to connect to the Internet, including routers, channel service units or data services units, modems, software and other products. Our Internet access services, which accounted for over 77% of our total revenues in 1999, include:

- *Dial-up Access.* Our dial-up access service enables users to connect to the Internet using a local telephone number. Our customers can connect to our Internet backbone through more than 800 local access points in the United States and, through our reseller relationship with iPass, a remote access provider, through approximately 1,500 international local access points in more than 150 countries. DiaLinx<sup>SM</sup>, which is our remote dial-up access service for enterprises that enables them to provide their mobile professionals, telecommuters, customers and business partners with guaranteed, cost-effective local dial-up access to their intranets and extranets, as well as the Internet, from around the world. Similarly, our DiaLinx ISP service enables Internet service providers to expand their existing dial-up access service without incurring substantial up-front capital costs and ongoing operational expenses. For other Internet service providers and organizations that want to quickly offer their customers a private-label, Internet dial-up access service without incurring up-front and ongoing investments in network infrastructure or the burden of providing back office support, we offer a virtual Internet service provider service, called DiaLinx VISP<sup>SM</sup>.
- *Dedicated Access.* Our Internet Advantage<sup>SM</sup> and ISP Direct<sup>SM</sup> services connect enterprises and service providers directly to the Internet through a dedicated high speed connection. These services are available throughout the United States and in more than 60 other countries. We offer a broad spectrum of dedicated connection types with flexible pricing structures, as well as comprehensive service level guarantees. We offer dedicated Internet access at speeds ranging from T1, including fractional up to 1.5 megabits per second, to OC-12, which is capable of transmitting data at 622 megabits per second.

- *Digital Subscriber Line Access.* Our digital subscriber line access service enables high speed digital transmission over telephone lines. This service allows an end user to use the telephone while connected to the Internet with only one connection. Unlike dial-up access services, our digital subscriber line access service provides a full-time connection that is “always on”. We currently offer service in 24 major metropolitan service areas throughout the United States, with expansion planned to over 50 major metropolitan service areas, covering over 60% of the United States population, by the end of 2000. Our digital subscriber line access services are available in a wide range of dedicated access speeds, from 144 kilobits per second to 1.5 megabits per second. Our digital subscriber line access services for enterprises are designed to meet the needs of telecommuters, branch offices and small businesses by providing high quality Internet access at speeds faster than dial-up and Integrated Services Digital Network and offered for a fixed monthly fee. In addition, for our service provider customers, we coordinate all activities necessary to provide digital subscriber line access service, including service establishment, network connectivity, bulk billing and second tier technical support.

*Web Hosting.* Our web hosting services, which accounted for 7% of our total revenues in 1999, enable enterprises and application service providers to outsource the storage and management of their web servers to our special purpose web hosting facilities. Our Enterprise Advantage<sup>SM</sup> web hosting service provides reliable web hosting and high speed network infrastructure, flexible, fast, and secure web hosting platforms and experienced technical support staff. We currently operate 10 data centers throughout the world, with eight in the United States, one in Leeds, England and one in Tokyo, Japan. Each data center is located in the same building as, or in close proximity to, our network access points. Our data centers are technologically advanced facilities with redundant, high speed connectivity to the Internet, uninterruptible power supplies, back-up generators, fire suppression, raised computer floors, separate cooling zones, seismically braced racks and high levels of security. Our Enterprise Advantage services include:

- *Managed Web Hosting.* Our managed web hosting service provides fully managed, secure and reliable web hosting capabilities for businesses operating in Windows NT or UNIX environments that want to use our expertise to implement and manage their web site infrastructure. We manage the systems and platforms and also retain ownership of equipment and software.
- *Customer Managed Web Hosting.* Our customer managed web hosting service is designed for enterprises that require administrative control of their web sites but prefer to partner with an experienced, reliable web hosting provider. This service provides our customers with pre-configured server hardware and software, Internet access and the benefit of secure and continuously monitored data centers. Our customers retain full responsibility for the content and administration of their web sites.
- *Collocation Web Hosting.* Our collocation web hosting service is designed for enterprises that seek to own their own equipment and retain full responsibility for management, content and administration of their web sites, but need a secure and scalable hosting facility with high performance connectivity.
- *Content Delivery and High Availability Services.* For customers with high traffic web sites, we also offer optional, high availability services that can increase web site capacity and performance. We currently offer four high availability services:
  - *LoadBalancer.* Our LoadBalancer<sup>SM</sup> service creates a single web address that represents multiple web servers located in a single data center. These web servers utilize advanced load balancing techniques, based on the number of users seeking access to the web site, to connect users to the web server that will produce the fastest response to their request.
  - *Traffic Distributor.* Our Traffic Distributor service is designed for web sites requiring high reliability and involves hosting web servers in multiple data centers. Enabled by our patent-pending Hopscotch<sup>TM</sup> load distribution technology, this service enhances the experience of an end user by directing their content requests to the web server offering the fastest and most reliable service.



- *Site Replicator.* Site Replicator enhances web site availability by mirroring web site content between multiple servers. Site Replicator copies new files, scripts and web images from the primary server to the other servers within its defined group. Site Replicator is a flexible web data replication tool, using efficient algorithms and intelligent data transfer techniques to minimize overhead and ensure that content on all web servers is synchronized.
- *Site Accelerator.* Site Accelerator replicates web site content on servers throughout our Internet backbone and brings this content geographically closer to our users, a process known as caching. This process reduces web page load times. Because this service is performed in our network, our customers receive the benefits of caching without any capital investment. Site Accelerator splits the task of serving content between the cache servers in our network and the dedicated web site servers. When the content is moved to our cache servers, the dedicated web site servers are freed up, permitting more users and more transactions without sacrificing performance from the perspective of the end user.

*Value-added e-Business Services.* As enterprises and service providers continue to use the Internet as a business-critical tool, we believe they will increasingly demand a wider range of e-business services to ensure security, enhance productivity, reduce costs and improve service reliability and scalability. Today, we offer a range of value-added e-business services, including:

- *Virtual Private Networks.* With our virtual private network service, we enable an enterprise and its employees, customers, suppliers and business partners to securely send and receive information to and from each other via encrypted dial-up, dedicated, digital subscriber line or cable-modem Internet connections. Our VPN Advantage<sup>SM</sup> service is a managed virtual private network service that makes it possible to communicate securely over our Internet backbone and over the Internet from virtually anywhere in the world. With VPN Advantage, our customers benefit from the capabilities of a large, shared IP-based network infrastructure while maintaining the look and feel of their own private corporate network.
- *Managed Security Services.* Our managed security services are scalable and can be customized to our customers' needs and provide a high level of protection for their corporate networks. Our managed security services include monitoring the network perimeters of our enterprise customers, 24 hours a day, seven days a week, and use of firewall management, maintenance and proactive response techniques to ensure the security of access points into their computing infrastructure. Our Site Patrol<sup>SM</sup> for FireWall-1<sup>®</sup> and our Security Advantage<sup>SM</sup> are Internet security services that help to significantly reduce exposure to Internet security threats and firewall breaches. In addition, we offer a vulnerability assessment service, Site Scan<sup>SM</sup>, that helps enterprises strengthen their network perimeter security by periodically testing for potential weaknesses and generating recommendations for correcting them.
- *Voice-over-Internet Protocol.* Through our suite of voice-over-IP services, including International VoIP Direct<sup>SM</sup> and ESP Direct<sup>SM</sup>, we offer low-cost, high-quality voice-over-IP network transport to Internet service providers, Internet telephony service providers, enhanced service providers and telecommunications companies providing voice-over-IP services to their customers. We seek to provide our customers with accelerated time-to-market for their customers through innovative, enhanced solutions enabling voice services such as personal computer-to-phone and personal computer-to-personal computer.

*Transport.* Our transport services are generally purchased by telecommunications carriers and Internet service providers requiring additional capacity. In delivering these services, we provide a single point of contact for planning, ordering, installing, billing, maintaining and managing the transport services of our customers. Our transport services, which accounted for 12% of our total revenues in 1999, include:

- *ATM Service.* Our asynchronous transfer mode, or ATM, transport service, a form of high speed data transfer, is targeted primarily at carriers and Internet service providers with high bandwidth voice, video and data transmission requirements. We provide ATM connections between one or more